



Prosperitas

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Prosperitas: Latin for prosperity & good fortune

The Good, The Bad & The Recovery

As we hurtle inevitably into another federal election campaign, various discussion points (of course mostly negative) continue to bombard us on a daily basis as we go about our busy lives. The newspaper headlines that tend to resonate will be the negative ones and it is sometimes hard to sort the fact from the fiction particularly when it comes to investment markets.

We were delivered a very fine example of this in late 2018 with the US market dropping nearly 20% which came with significant media attention. Unfortunately, as the market has recovered nearly all of the losses, the media has tended to focus elsewhere. The state of the two major property markets in Australia have been under pressure but as we all know, they were due for some softening following many years of sound returns.

What we have seen in recent times is an appetite for investment when markets do fall which has been driven by very low cash rates which can make equity or property investment quite compelling. We have written here about the importance of the price you pay for an asset which is perhaps of greater importance than it ever has been. Value investing is not a new concept but has gone out of vogue in recent times with asset prices receiving terrific tailwinds

from central banks around the world. With more volatility in equity markets looking to be the 'new normal' it's a style of investing that looks to be of particular interest to us.

As the leaves start to turn, the Garden Gnome has delivered the very best of advice to get your garden ready for winter and we introduce The Binge Dweller to our audience with a terrific TV show for the cooler months. 'It's a Fact Jack' has generated a lot of interest and we welcome back the segment with some interesting tidbits for your daily commute. We hope you enjoy the latest edition of *Prosperitas* and look forward to seeing you next time you come into the office.

Martin R McIntosh
Managing Partner

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Investment Cycle: Is It Different This Time?

Financial market cycles don't last forever, or at least that's what history over many decades has proven. However, the current environment has been challenging for value style investing and instead we have witnessed for an extended period an environment that has favoured growth and momentum investing. Fear of missing out is at a peak - people are willing to pay just about any price to chase a return and have forgotten to think about other important criteria. This begs the question – Is it different this time?

True to label value investors, don't believe it is different and they think about the following all of the time, throughout all market cycles:

What does the company make?

This is not a just a query about revenue! What does a company really make? If it is a resource company, is it actually extracting resources from the ground? Does the company invest in mines that have long mine lives? If it is a technology company, what difference is it really making to people's lives? If the company is a 'disruptor', can it too be disrupted? Remember Nokia? And Blackberry? And then along came the Apple iPhone.

What does the company make?

This time the question is about revenue. A company must make money – too many listed businesses are currently building their share price based on promises and hope. Value investors will generally not investigate investing in a company unless the company has reported at least 3 years of solid recurring earnings. Keep an eye on global companies such as Tesla and music streaming business 'Spotify'.

What does the company do?

Is the company a monopoly, or a duopoly? There is often little value in risking an investment in a business whose competitors can easily overcome barriers to entry. Yes – competition can be good for consumers, but not necessarily profitable for investors. Travel operators could fall into this category; Webjet, booking.com, Expedia, Flight Centre, Corporate Travel Management, Hello World, cheapflights.com.au; skyscanner, farecompare to list a few!

How much has the company borrowed?

This is probably the most important question of all. Value investors forensically scrutinise balance sheets. A company that has high debt levels and low or volatile cash flow is a company at risk. The current argument is "But interest rates are so low!", however it doesn't matter if you borrowed at 4%, 8%, or 18%, an increase - even a minor increase in interest rates can have a detrimental effect on company balance sheets. In times of low interest rates, some businesses grow inorganically – i.e. borrowing to buy out their competitors, or even buying businesses that are not aligned with their own expertise – the more they buy, the worse the quality of the acquisition becomes. Think Westpoint leading into the GFC, a company that owed \$312million at the time of its collapse and had just \$21million in net assets. Think Slater and Gordon in more recent times, a compulsive over-acquirer.

What price do you pay?

There are some great companies (and some that are questionable) that are currently enjoying a high share price, and many investors have benefitted from the rise of the value of the company. But is now the time to buy businesses such as Afterpay? Or, like a true to label value investor, do you mercilessly scrutinise the company and then wait until the company is "On Sale"



Quality value style fund managers continue to ask the hard questions of company management to ensure their decisions result in investing prudently on behalf of investors at all times. Experienced, long term value managers who have worked through a number of financial market cycles will admit that they have not witnessed a market like the current one ever before. There are a number of reasons that this time could be perceived as different, but ultimately quality value managers will not waiver from their process and philosophy and in 2019 they are monitoring closely the following 'X' factors that could impact markets and see a fall in growth stocks and momentum investing both globally and domestically:

- a record government shutdown in the US; 35 days across December and January
- an unresolved Brexit
- the worst Chinese GDP in 40 years
- the trade war between China and the US
- toxic politics within Australia
- European nations on the brink of bankruptcy
- asset prices are at sky high levels as Quantitative Easing has blown a "double bubble" in bonds and equities bigger than the technology bubble in 2000 and the housing bubble in 2007



So, if it is NOT different this time, and history is more than likely to be repeated, which companies with questionable business models, little or no earnings, poor barriers to entry, high debt levels, and suspect cash flow will provide legendary value investor, Warren Buffet permission to yet again be able to state:

“ *You never know who is swimming naked until the tide goes out* ”



Garden Clippings



What gardener doesn't enjoy the cooler mornings, clear days and occasional rain of autumn? Well I can assure you that the Garden Gnome is with you all and happily attending to the following amid the fallen leaves;

- It's time to plant garlic bulbs. Split the head into individual cloves and plant tip up into well drained soil – 3 – 5cm deep and 7cm apart should do. Your garlic supply will be abundant in late spring and early summer. Be careful to plant locally grown product to ensure success.
- Remove summer crops from your veggie patch and rejuvenate your soil with compost in preparation for your autumn planting – broad beans, broccoli, cabbage, cauliflower, chives, coriander, kale, leek, lettuce, onion, peas, radish, sage, spinach, spring onion, swede, thyme, turnip.
- Spring flowering bulbs should be planted this month. Prepare the ground to a crumbly texture and plant the bulbs tip up. As a rule, bulbs are planted to a depth that is twice their length.

Happy planting!

GG

It's a Fact, Jack!

- Marie Curie's notebooks will remain radioactive for at least another 1,500 years. Researchers wishing to study her notes must sign a waiver in order to do so.
- Russia didn't consider beer to be alcohol until 2011. It was previously classified as a soft drink.
- Guinness Book of Records holds the record for being the book most often stolen from Public Libraries.
- Koalas have fingerprints that are indistinguishable from human ones.
- In 1963, SF Giants' Manager Alvin Dark said of pitcher Gaylord Perry "They'll put a man on the moon before he hits a home run." On July 20, 1969, moments after Neil Armstrong set foot on the moon, Perry hit his first home run.
- The Killer Whale is technically a dolphin as it has teeth; however, as all dolphins are whales, then for all intents and purposes, it is actually a whale.
- If you lift your writing-side foot off the floor and make clockwise circles and then draw the number 6 your foot will change direction.
- A poll of over 45,000 readers of New York Times found that people are more likely to believe a statement in Baskerville than any other font.
- Although it seems counter-intuitive, a pound of feathers weighs more than a pound of gold. This is because feathers are weighed in the avourdupois measurement system and gold in the troy measurement system.
- Switzerland is the only country to have boycotted a Summer Olympic Games yet win a medal at the same Games.
- For safety reasons, mercaptan is added to gas to give it its distinctive smell. Otherwise, it would be odourless.

Note: All above facts have been printed in Baskerville.

The Binge Dweller

Binge Factor:



TV Review: Le Bureau des Légendes (The Bureau)

Given the title of this Newsletter is in Latin, it seems only fitting that we select a show using a derivation of that language for our first TV Review.

Initially screening in 2017 and still available via SBS On Demand, The Bureau showcases an inside view of the French national foreign intelligence agency. The series focuses, in particular, on the department in charge of training agents and creating their fake identities when they go undercover.

The writers of the show were granted permission by the agency to meet with agents and visit their offices in order to replicate the agency and make the series as authentic as possible. The results are outstanding and it's the restraint shown by the writers that makes it so compelling. The characters are given time to form and equally the plotlines develop at a pace which allows us to fully engage with the story.

Season 1 of The Bureau deals with the story of Agent Malotru who has

been recalled to Paris after 6 years in Damascus which included an affair with Nadia El Mansour which has to end when he leaves Syria. Malotru is struggling to adapt to his life back in Paris and his absence from Nadia. When he discovers that Nadia is in Paris things get complicated as he has to also train a new agent and try and rescue an agent who has gone missing in Algeria.

The entire four seasons are spectacularly filmed on location from Paris to Damascus, Algiers to Tehran, and Baku to Moscow. Added to the first class writing and characters makes this some of the finest television ever made.

If you are looking for car chases, explosions, and shoe phones then this series may not be for you; however, if you are looking for a series that gradually reveals more and more of the story with a level of nuance normally reserved for novels, then The Bureau should be at the top of your list.

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